16

No. 7739

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

THE BANK OF CALIFORNIA, NATIONAL ASSOCIATION,
Respondent.

BRIEF FOR RESPONDENT.

F. D. MADISON,
ALFRED SUTRO,
FELIX T. SMITH,
MARSHALL P. MADISON,
Standard Oil Building, San Francisco,
Attorneys for Respondent.

FILED
2 - 1924

Subject Index

Table of Authorities Cited

Statutes

No. 7739

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

THE BANK OF CALIFORNIA, NATIONAL ASSOCIATION,
Respondent.

BRIEF FOR RESPONDENT.

THE FACTS.

From various dealers respondent purchased "tax exempt" bonds at fixed prices plus interest accrued on the bonds. To the same dealers respondent resold the same bonds, at later dates, for the same prices, plus interest accrued on the bonds. Respondent cashed and collected interest coupons maturing in the interim. Interest accruing on the bonds in the interim was received and retained by respondent for its own account.

Petitioner asserted that this interest was "taxable in accordance with the decisions in the cases of First National Bank of Wichita and Brown-Crummer Company, B.T.A. volume 19, #5, pages 745 and 750."[1]

1. R. 14.

In the instant case the Board of Tax Appeals held respondent was entitled to the exemption, saying of the *Wichita* situation:

> "The facts in the cited cases are very different from those in the case at bar * * *. There, upon the maturity of the interest coupon, the Bank clipped the coupon and delivered it to its customer; here, the petitioner collected the coupon and credited the proceeds thereof to its own interest account."[2]

ARGUMENT.

1. RESPONDENT RECEIVED NO INTEREST EXCEPT THAT ACCRUING ON THE BONDS THEMSELVES. IT CANNOT BE TAXED FOR INTEREST IT DID NOT RECEIVE.

For tax purposes, the critical question in cases of this kind is always who it was who received the tax exempt interest. On that question of fact the present record is clear beyond doubt. The petition for review itself alleges expressly that under the arrangement respondent "was permitted to collect the interest coupons on the securities while it was in possession of same."[3] The contracts provided expressly: "Maturing coupons to be the property of The Bank of California, N.A."[4] This is conclusive.

Quite irrespective of all questions regarding the ownership of the bonds themselves, it is settled that interest collected by the owner of a coupon as it matures is income of the owner of the coupon and not of the bond.

Julius Rosenwald had organized a charitable corporation. He clipped and delivered to it before maturity

2. R. 42.
3. R. 48.
4. Petitioner's Ex. 1, R. 59; see also R. 17, 30, 34.

interest coupons from certain liberty bonds. The Circuit Court of Appeals for the Seventh Circuit held that the interest on these coupons could not be taxed as part of Rosenwald's income.[5]

There can be no doubt on this point. Estates, trusts and other interests in property have produced frequent situations in which the rent, dividends, or interest—the usufruct—of property, is separated from the ultimate ownership of the property itself. Our tax law is not concerned with technical legal distinctions about the ownership of the property which produces income. Its concern is a very practical one. It merely ascertains the person who receives the income and taxes him accordingly.

The ultimate decision of the very case upon which petitioner relied turned upon this very question. The Circuit Court of Appeals for the Tenth Circuit said:

> "There is no doubt of the exemption from income taxes of the interest on these securities in favor of the person or persons who were entitled to receive it and did receive it."
>
> "Conceding that under the contract the legal title to the bonds was in the bank, the uniform conduct and practice of the parties was a joint admission *that the interest coupons and their proceeds when collected did not belong to the bank,* but were the property of Brown-Crummer Company. They were collected by Brown-Crummer Company and applied to its use and benefit. When the coupons were detached from the bonds by the bank and delivered to Brown-Crummer Company, the interest represented by them 'was no longer a mere incident of the principal indebtedness represented by the bond', and the coupons became in-

5. *Rosenwald v. Commissioner*, 33 F. (2d) 423.

dependent obligations, separate and apart from the bonds. Edwards v. Bates County, 163 U.S. 269, 272, 16 S.Ct. 967, 41 L. Ed. 155; Nesbit v. Riverside Independent District, 144 U.S. 610, 12 S.Ct. 746, 36 L. Ed. 562. *The bank got none of the interest that accrued on the bonds.* It was not entitled to it. Brown-Crummer Company paid the bank all its interest charges. The Board of Tax Appeals held that these interest charges received by the bank from Brown-Crummer Company should be included in the bank's taxable income."[6]

As we have shown, it has never been contended that anyone other than the respondent received the interest on these tax exempt bonds. Respondent's income tax, therefore, was properly adjusted on that basis.

---

2. PETITIONER'S BRIEF DISCLOSES NO REASON FOR QUESTIONING THE RESULT REACHED BY THE BOARD.

(a) No substantial question of fact is raised.

It is not easy to ascertain the precise attitude of petitioner towards the facts. He makes an elaborate restatement of facts found by the Board,[7] and follows that with a statement of "other facts".[8] There is no definite attempt to point out wherein the Board erred so far as the facts

---

6. *First Nat. Bank in Wichita v. Commissioner of Int. Rev.*, 57 F. (2d) 7, 9.

The Board's decision in that case was to the same effect.

"The question here, as we view it, is not dependent upon who held the bare legal title to the bonds during the dates of sale and repurchase, but rather upon the broader issue as to whom, under the understanding between the bank and its customers, was entitled to receive, and who, as carried out, did receive the interest payments made by the issuing authorities of such bonds when collected and paid" (*First National Bank in Wichita v. Commissioner*, 19 B.T.A. 744, 749).

7. Petitioner's Br., pp. 3-7.

8. Petitioner's Br., pp. 8-9.

are concerned. Regarding these "other facts", however, the following may be noted:

It is quite insignificant that these transactions "were handled by respondent's 'note department.'"[9] Banker's acceptances and commercial paper were carried at the note desk.[10] All these investments were assigned to that department purely for reasons of convenience.[11]

The petitioner intimates[12] that by these agreements the bank could "advance" more money than the law permitted. In the passage cited by petitioner such was not the language of the witness, but only of his interrogator.[13] The phrase the witness used was "place the funds with them", "putting our clients into possession of more money."[14] If by mentioning this point petitioner seeks to suggest that it was intended to evade the banking law, the answer is plain that that very intention would necessarily exclude any intent of evading the tax law, and the tax law is the only matter here at issue. (Of course there was no evasion of either law.) In fact, the only possible materiality of this circumstance is to rebut petitioner's position[15] that the transaction was in fact a loan by demonstrating that no such loan could legally have been made.

That the bonds "were always repurchased by the dealer"[16] is merely a statement that the parties complied with their contracts and is quite immaterial.

---

9. Petitioner's Br., p. 8.
10. R. 71.
11. R. 68, 71.
12. Petitioner's Br., p. 8.
13. R. 73.
14. R. 71.
15. *Infra*, pp. 11-26.
16. Petitioner's Br., p. 8.

That the price was slightly "less than the market price"[17] is explained by "the fact that the bonds in substantial quantities did not have a ready market * * *. That is a factor which should have entered into our determination in fixing market price."[18]

The petitioner errs in quoting the record as showing that "the dealer here found it necessary 'to borrow substantial sums.'"[19] In this connection, all the witness said was: "It was necessary *to finance* the business *either* through borrowings, *or through the sale of the bonds, the temporary sale and repurchase of the bonds.*"[20]

The remaining "other facts"[21] are equally immaterial.

(b) There is no real assignment of error.

The brief fails to comply with the rule of this court that it "set out separately and particularly each error asserted and intended to be urged".[22]

The rule does not permit incorporation by reference as attempted by petitioner.[23] This reference is followed by a summary which mentions only some of the points in the assignment.[24]

The majority of the formal assignments[25] are based upon alleged failure of the Board to take certain action. The record contains nothing to show that the Board was ever asked to take any such action. Obviously error cannot be assigned.

---

17. Petitioner's Br., p. 8.
18. R. 79.
19. Petitioner's Br., p. 8.
20. R. 80.
21. Petitioner's Br., pp. 8-9.
22. Rule 24, subdivision 2 (b).
23. Petitioner's Br., p. 9.
24. Petitioner's Br., pp. 9-10.
25. R. 49-50.

Seriatim the following is the situation regarding the assignments in the record:

> "1. The Board erred in holding that the interest received by the taxpayer was exempt from taxation."[26]

This is the real point in the case. Legally it is clearly untenable. The person who received the interest was undoubtedly entitled to the exemption.[27]

> "2. The Board erred in failing to hold that the interest received by the taxpayer was taxable to it."[28]

This assignment can hardly be considered. It is not mentioned in petitioner's summary.[29] Mere "failing to hold" is not error where there was no request for the holding.[30] In any event, since "the interest received by the taxpayer" was coupon interest on tax exempt bonds and necessarily exempt, the assignment is untenable. Petitioner does not argue the point. It may be taken as properly abandoned.

> "3. The Board erred in failing to find and hold that the interest in question was received by the taxpayer on loans to customers."[31]

Again, there can be no error "in failing to find and hold" anything where the Board was not asked for such a finding or holding.[32] In any event, on the present record it is clear that it would have been error for the Board to

26. R. 49.
27. *Supra*, pp. 2-4.
28. R. 49.
29. Petitioner's Br., pp. 9-10; *supra*, p. 6.
30. *Supra*, p. 6.
31. R. 49.
32. *Supra*, p. 6.

find or hold that "the interest coupons on the securities"[33] could have been "interest * * * on loans to customers".[34]

> "4. The Board erred in finding and holding that the taxpayer received the interest in question as the owner of tax exempt securities."[35]

This assignment is not mentioned in the summary[36] or elsewhere in the brief and is taken as abandoned. In any event, it can be interpreted only as having to do with the matter of title to the bonds, a purely collateral question.[37]

> "5. The Board erred in holding that the securities in question were purchased by the taxpayer."[38]

This again relates to the collateral question of title.[39] So far as evidence is concerned, the record is full of uncontradicted evidence of these purchases. See, for example, the bill of sale in Petitioner's Exhibit Number 1.[40]

> "6. The Board erred in finding that the taxpayer treated the bonds held under the repurchase agreement as it did all its bonds and other investments."[41]

This is a purely evidentiary matter. The finding, however, is directly supported by the record.[42]

---

33. R. 48.
34. R. 49; *supra*, pp. 2-4.
35. R. 49.
36. Petitioner's Br., pp. 9-10; *supra*, p. 6.
37. *Supra*, pp. 2-4; *infra*, pp. 11-13.
38. R. 49.
39. *Supra*, pp. 2-4; *infra*, pp. 11-13.
40. R. 58.
41. R. 49.
42. "Our treatment of interest on what I have described as these short term investments under repurchase agreement was precisely the same as our treatment as to interest derived by the bank from investments of the long term portfolio" (R. 62).

"When the Comptroller of Currency periodically issued his call, the bonds returned by us in our statement, which were subject to repurchase agreements were handled as property of the bank, in the same way that our own—the two accounts were combined for the government comptroller reports. * * * In our statement we listed bonds held subject to repurchase agreement in the same manner as we returned all other bonds owned by the bank" (R. 66-67; see also R. 68).

"7. The Board erred in failing to find that the repurchase agreements were always carried out."[43]

Again, there can be no error in failing to make a finding not requested.[44] Any such finding, of course, would have been immaterial.[45]

"8. The Board erred in finding and holding that the taxpayer was not required to account to the Moulton Company for any surplus on a sale."[46]

This assignment is not mentioned in the summary.[47] It is directly in accord with the repurchase agreement in evidence.[48]

"9. The Board erred in finding that no special consideration or conditions other than those set forth in the contract motivated the actions of the parties."[49]

There was no evidence of any such special considerations or conditions.

"10. The Board erred in failing to find that the transactions in the form of sales and repurchases of the securities in question were occasioned by the desire of the parties to circumvent or avoid the banking restrictions under which the taxpayer in its loans on collateral to any person or firm was limited to 10% of its capital and surplus."[50]

As we have said, there can be no error in failing to make a finding not requested.[51]

---

43. R. 49.
44. *Supra*, p. 6.
45. *Supra*, p. 5.
46. R. 50.
47. Petitioner's Br., pp. 9-10; *supra*, p. 6.
48. Petitioner's Ex. No. 1, R. 59-60.
49. R. 50.
50. R. 50.
51. *Supra*, p. 6.

In any event, the finding could only have been either immaterial or in our favor.[52]

> "11. The Board erred in failing to find that at all times R. H. Moulton & Company treated the securities in question as its own."[53]

Again, failure to make a finding not requested cannot be error.[54] No such finding could have been supported by the evidence. Moulton & Company conveyed the bonds by bill of sale[55] and subsequently repurchased them by bill of sale.[56] It permitted respondent to collect and retain the interest accruing in the meantime.[57] In any event, whatever Moulton did could not be binding upon respondent or subject it to a tax not warranted by its own conduct.

> "12. The Board erred in failing to find that very frequently the taxpayer furnished the money to R. H. Moulton & Company to make the original purchase of the tax-exempt securities."[58]

Again, failure to make a finding not requested cannot be error. The finding could not have been material.

> "13. The Board erred in failing to find that in many instances R. H. Moulton & Company sold to its customers some of the securities held by the taxpayer and would exercise the repurchase agreement to the extent of obtaining securities necessary for delivery to the customer."[59]

---

52. *Supra*, p. 5; *infra*, p. 16.
53. R. 50.
54. *Supra*, p. 6.
55. Petitioner's Ex. No. 1, R. 58.
56. Petitioner's Ex. No. 2, R. 64-66.
57. R. 48; *supra*, p. 2.
58. R. 50.
59. R. 50.

Again, failure to make a finding not requested cannot be error. The finding could not have been material.

> "14. The Board erred in holding and deciding that there are no deficiencies in tax for the years 1928 and 1929."[60]

This is a mere general assignment.

> "15. The Board erred in not holding and deciding that there are deficiencies in tax for the years 1928 and 1929 in the respective amounts of $2439.76 and $1620.52."[61]

This also is a purely general assignment.

(c) Petitioner's argument cannot warrant reversal.

The argument is simply that these were not sales and repurchases but loans and mortgages or pledges.[62] It is also apparent, since the Board has found the facts against petitioner, that he must argue that his contention about the character of these transactions follows necessarily as a matter of law from the very transactions themselves.

(1) The argument is beside the point.

From what we have said[63] it is apparent that the decision of this tax case cannot turn upon the question argued in petitioner's brief, upon whether or not these transactions were sales and repurchases or loans and mortgages or pledges, upon any question regarding the ownership of the bonds, but upon the fact that respondent received the interest and owned the interest. Petitioner's "summary of argument"[64] discloses an unconscious re-

60. R. 50.
61. R. 50-51.
62. Petitioner's Br., p. 12, et seq.
63. *Supra*, pp. 2-4.
64. Petitioner's Br., p. 10.

alization of the fact that the reversal of the case certainly required the establishment of some legal principle beyond that argued in the brief. He says: "It is clear that the interest which respondent received was actually the price the original seller paid for loans."[65] Even if it were the fact that the coupons, the right to receive and retain the interest, became respondent's property as a condition of or consideration for a loan, it cannot follow that for that reason the interest received on these coupons lost its tax exempt character. Petitioner proceeds: "That such interest did not become tax exempt in the hands of the respondent merely because paid out of interest due on the bonds."[66] This loses sight of the fact that no one is claiming that the interest should "become tax exempt." The interest was tax exempt by virtue of the character of the bonds to which the coupons were originally attached. It was tax exempt in the hands of the person entitled to collect it. To say that "such interest" was "paid out of the interest due on the bonds" is to make an assumption contrary to the established facts. The only interest here involved is the "interest due on the bonds." Nothing was "paid out" of this interest. This interest itself was simply paid to and retained by the respondent.[67] It did not become tax exempt. It always was tax exempt.

Petitioner's summary states that "the right to claim the exemption was limited to the latter"—the owner of the bonds.[68] For that statement no authority is cited. There is none.

---

65. Petitioner's Br., p. 11.
66. Petitioner's Br., p. 11.
67. R. 48; *supra*, p. 2.
68. Petitioner's Br., p. 11.

Apart from this "summary" there is nothing in the brief, nothing in the argument itself, except the statement that "Moulton & Company remained the owner of the bonds, the interest therefrom belonged to that company, and it alone can claim the privilege of tax exemption on such income".[69] To say that "the interest therefrom belonged to" Moulton is simply to make an assertion directly contrary to the record, which shows "maturing coupons to be the property of The Bank of California, N. A.".[70] To say that Moulton "alone could claim the privilege of tax exemption" is to state a mere conclusion directly contrary to the decided cases,[71] for which petitioner offers neither argument nor authority.

(2) The transaction was not a loan, not a mortgage, not a pledge.

As we have seen, petitioner's position is that as a matter of law the transaction, which on its face purported to be a sale and repurchase, could not have been what it purported on its face to be, what the parties intended it to be, but on some legal principle must be given a different character. There is no such legal principle. In proper cases, of course, deeds have been given the effect of mortgages. The very cases, however, upon which petitioner relies in support of this, establish not only that it is not a universal principle of law but that it cannot be applied to circumstances like those at bar.

The leading case is *Conway v. Alexander*.[72] That case involved a conditional sale of land. In reversing the con-

69. Petitioner's Br., p. 12.
70. Petitioner's Ex. No. 1, R. 59.
71. *Supra*, pp. 2-4.
72. 7 Cranch 218. Petitioner's Br., p. 28.

clusion of the lower court that the sale should be treated as a mortgage Marshall, C. J., said:

> "To deny the power of two individuals, capable of acting for themselves, to make a contract for the purchase and sale of lands, defeasible by the payment of money at a future day, or, in other words, to make a sale, with a reservation to the vendor, of a right to repurchase the same land, at a fixed price, and at a specified time, would be to transfer to the court of chancery, in a considerable degree, the guardianship of adults as well as infants. Such contracts are certainly not prohibited, either by the letter or the policy of the law. * * * But as a conditional sale, if really intended, is valid, the inquiry in every case must be, whether the contract in the specific case is a security for the repayment of money, or an actual sale?"[73]

The asterisks in this passage represent what is probably the portion of the opinion for which petitioner cites it. Petitioner propounds the decision as holding that "It is the policy of the law to prohibit the conversion of a conveyance for security into a sale".[74] This is not what Marshall, C. J., said. His words were "But the policy of the law does prohibit the conversion of a *real mortgage* into a sale". Whether or not we have a "real mortgage" can only be determined by a consideration of all the circumstances. It is not a legal principle that every sale and repurchase is necessarily a loan and mortgage.

Several of the circumstances relied upon by the court in *Conway v. Alexander* have striking parallels in the case at bar.

---

73. P. 237.
74. Petitioner's Br., p. 28.

Marshall, C. J., pointed out: "There is no acknowledgment of a pre-existing debt".[75] In the instant case there was no pre-existing debt.

Marshall, C. J., held that it was "a necessary ingredient in a mortgage, that the mortgagee should have a remedy against the person of the debtor".[76] In that case there was no such remedy, because there was no covenant to repay. Petitioner insists, of course, that in the instant case he can find "repurchase an absolute obligation on the part of the original 'seller' ", that "the promise of R. H. Moulton & Company to repurchase the bonds was absolute and not optional".[77] This obligation, however, did not create a debt, did not permit a "remedy against the person of the debtor". The contract here involved was a sale, not of realty, but of personalty. It could not be enforced specifically by the seller. It was limited to an action for damages, "the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted",[78] or the alternative remedy given by the contract itself to "sell * * * charging the loss, if any, to the account of the Buyer".[79]

Proceeding, Marshall, C. J., emphasized:

> "It is certain, that this deed was not given to secure a pre-existing debt."[80]

75. P. 237.
76. P. 237.
77. Petitioner's Br., pp. 13, 18.
78. Civ. Code, section 1784.
79. Repurchase Agreement, Petitioner's Ex. No. 1, R. 60.
80. P. 238.

So here.

"There is not, however," said Marshall, C. J., "a syllable in the cause, intimating a proposition to borrow money, or to mortgage property."[81] So here.

Again the court said:

> "To this circumstance, the court attaches much importance. Had there been any treaty—any conversation respecting a loan or a mortgage, the deed might have been, with more reason, considered as a cover intended to veil a transaction differing in reality from the appearance it assumed. But there was no such conversation. The parties met and treated upon the ground of sale and not of mortgage."[82]

Such is the situation here.

> "It is not entirely unworthy of notice," said the court, "that William Lyles was not a lender of money, nor a man who was in the habit of placing his funds beyond his reach. * * * His not being in the practice of lending money, is certainly an argument against his intending this transaction as a loan."[83]

In the instant case the bank could not have made such a loan to Moulton.[84]

The instant case is stronger than the *Conway* case because of the absence of those very circumstances which Marshall, C. J., thought might raise some doubt. "The sale," said he, "on the part of Alexander, was not completely voluntary. He was in jail, and was much pressed for a sum of money."[85] Moulton, however, was not in

81. Pp. 238-239.
82. P. 239.
83. P. 239.
84. *Supra*, p. 5.
85. P. 240.

jail—was one of the most responsible financial houses in the community.

"The excessive inadequacy of price would, in itself, in the opinion of some of the judges, furnish irresistible proof that a sale could not have been intended."[86] In the instant case the price represented the fair market for blocks of securities of this kind.[87]

Henley v. Hotaling followed the same principles.[88] The case resembles that at bar to some extent in the circumstance that there the sale was made by an agent whose power of attorney did not permit him to mortgage, while here the purchase was made by a bank organized under laws which did not permit it to lend.[89]

Equally pertinent to this case would have been the remark of that maker of California legal history in the *Hotaling* case:

> "The parties gave me positive instructions to have it a sale, and not a mortgage, and if those papers make it anything else, then the papers did not perform the object of the parties and their transaction."[90]

The court said:

> "When the intention of the parties to a deed, absolute in form, is sought to be ascertained, not in the usual way, by reading and construing the instrument, in connection with evidence to identify the subject-matter, the parties, etc., but by evidence to establish an equity beyond and outside of the deed, and thus to convert the deed into a mortgage, the evi-

86. P. 241.
87. *Supra*, p. 6.
88. 41 Cal. 22; Petitioner's Br., p. 15.
89. *Supra*, p. 5.
90. P. 26.

dence ought to be so clear as to leave no doubt that the real intention of the parties was to execute a mortgage, otherwise the intention appearing on the face of the deed ought to prevail. *There can be no question that a party may make a purchase of lands either in satisfaction of a precedent debt or for a consideration then paid, and may at the same time contract to reconvey the lands upon the payment of a certain sum, without any intention on the part of either party that the transaction should be, in effect, a mortgage. There is no absolute rule that the covenant to reconvey shall be regarded, either in law or equity, as a defeasance.* The covenant to reconvey, it is true, may be one fact, taken in connection with other facts, going to show that the parties really intended the deed to operate as a mortgage, but standing alone, it is not sufficient to work that result. The owner of the lands may be willing to sell at the price agreed upon, and the purchaser may also be willing to give his vendor the right to repurchase upon specified terms; and if such appears to be the intention of the parties, it is not the duty of the Court to attribute to them a different intention. Such a contract is not opposed to public policy, nor is it in any sense illegal; and Courts would depart from the line of their duties should they, in disregard of the real intention of the parties, declare it to be a mortgage.''[91]

The court then quoted the language of Marshall, C. J., in *Conway v. Alexander.*

Quite similar is *Felton v. Grier.*[92] That is a strong case because the repurchase obligation was actually represented

91. Pp. 26-27.
92. 109 Georgia 320, 35 S. E. 175.

by promissory notes. Discussing a remark of Chancellor Kent's, Lumpkin, P. J., said:

> "We cannot believe the author of this rule ever meant to assert that if two sane persons, legally capable of contracting, knowingly, voluntarily, and actually intended to make an agreement by the terms of which one should sell property to the other for cash, receive the money, and bind himself to repurchase at a higher price, payable in the future, they could not possibly accomplish their design."[93]

He quoted the remarks of Marshall, C. J.,[94] and continued:

> "As above indicated, that question, reduced to its last analysis, is simply this: Is it a legal impossibility for two parties to agree between themselves that one shall buy property from the other for cash, and contemporaneously contract to resell, in consideration of the original seller's binding undertaking to repurchase on time at an advanced price. * * * It is settled for us that Grier and Felton did exactly what the jury said they did, and we simply hold that it is within the power of rational and independent adults, if they really desire and intend to do a thing of this kind, to legally accomplish their purpose. We cannot undertake to say it is absolutely out of the question for such a transaction to take place. It would be tantamount to holding that a fact actually accomplished was an impossibility."[95]

In at least one element which petitioner has emphasized[96] the case at bar also resembles *Wallace v. John-*

93. P. 177.
94. *Supra*, pp. 14-16.
95. P. 178.
96. *Supra*, p. 6.

stone.[97] The court there held that the transaction was a sale and not a mortgage and disposed of petitioner's contention saying:

> "But it is urged by appellant's counsel that the disparity between the price paid for the lands and their actual value shows the transaction to be a loan, and not a purchase. The evidence on this subject is at first view contradictory; some of the witnesses putting a market value per acre of such lands in large lots at the price paid for them by the appellees; others stating their value to be from $2.50 to $3.00 per acre. The real fact, taking all the testimony together, seems to be that those lands, when sold in small areas to actual settlers for the purposes of habitation, would bring the higher prices, whilst in large quantities they could be sold to speculators, for profit, only at the lower prices."[98]

Under similar circumstances, a conveyance of land was held to be a sale and not a mortgage.[99] Apparently for the reason we have noted,[100] such decisions are even more frequent, where, as here, the sale was of personalty.[101] These cases of agreements of this kind regarding personalty are, as we have said,[102] of great importance in determining the case at bar, which also regards personalty. A sale of realty is specifically enforcible. When the contract is executed an equitable conversion occurs. This is

97. 129 U. S. 58.
98. P. 64.
99. *Mitchell v. Wellman,* 80 Ala. 16.
100. *Supra,* p. 15.
101. *Beck v. Blue,* 42 Ala. 32;
Morris v. Angle, 42 Cal. 236;
Poindexter v. McCannon, 16 N. C. 331;
Brennan v. Crouch, 10 N. Y. S. 419, 57 Hun. 585, affirmed 125 N. Y. 763, 26 N. E. 620;
Youssoupoff v. Widener, 246 N. Y. 174, 158 N. E. 64.
102. *Supra,* p. 15.

not true with personalty. A suggestion in *Morris v. Angle*[103] may well be applicable here. Suppose while the bank held them subject to the repurchase agreement, the bonds had been stolen, lost or destroyed. Respondent then would not have been able to tender the bonds to the dealer when the date fixed for repurchase came. Since the dealer had no liability except to repurchase, since no debt apart from the obligation to repurchase existed, the loss would have fallen upon respondent. This circumstance alone shows the essential difference between the transactions which actually occurred between the dealer and respondent and the loan and mortgage or pledge to which petitioner seeks to assimilate them.

(3) Petitioner's authorities do not support his contention.

Kelter v. American Bankers' Finance Co.[104] held certain assignments were in fact security for a loan. The court went into all the circumstances and relied largely upon the outstanding one, that as in the *Hotaling* case,[105] there was actually an interest charge made by the lender to the borrower. The case does not hold, petitioner indeed does not claim that it holds, that every sale of securities with the right of repurchase is a loan and not what it purports to be.

Keifer v. Myers[106] held a transfer of stock a pledge and not a sale. It is based upon the fact that the transferee gave no consideration for the stock and did not cancel the existing liability of the transferor to him, that there was no fixed price for the repurchase and above all that

103. *Supra*, p. 20.
104. 306 Pa. 483, 160 Atl. 127; Petitioner's Br., p. 14.
105. *Supra*, p. 17.
106. 5 Cal. App. 668; Petitioner's Br., p. 14.

the transferor "was chargeable with interest and credited with dividends".[107] The case is essentially different from ours.

Jackson v. Lawrence[108] and *Peugh v. Davis,*[109] were simple cases of deeds admittedly intended as mortgages.

In *Russell v. Southard*[110] the evidence was conflicting and the court held in favor of the witnesses who testified a mortgage was intended.

In *Whittemore v. Fisher*[111] the evidence was clear and explicit that no sale was intended, but merely security.

In *Robinson v. Farrelly*[112] the demurrer admitted that a mortgage was intended. Petitioner quotes a passage from this case which lays down as the determinative test the question, if there is a debt, whether the purchaser has "the right to demand the money of the vendor". As we have seen,[113] respondent here had no such right, only the right to tender the bonds on the day fixed for the sale and if the dealer did not take them, to sue for damages.

In *Weiseham v. Hocker*[114] the evidence showed conclusively that the conveyance was made to secure an existing indebtedness.

Shelley v. Byers[115] involved an instrument which, on its face, presented an ambiguity whether a sale or pledge was intended. The court construed the instrument itself

---

107. P. 673.
108. 117 U. S. 679; Petitioner's Br., p. 14.
109. 96 U. S. 332; Petitioner's Br., p. 14.
110. 12 How. 138; Petitioner's Br., p. 14.
111. 132 Ill. 243, 24 N. E. 636; Petitioner's Br., p. 14.
112. 16 Ala. 472; Petitioner's Br., pp. 14, 17, 21.
113. *Supra*, pp. 15, 20-21.
114. 7 Okla. 250, 54 Pac. 464; Petitioner's Br., p. 14.
115. 73 Cal. App. 44; Petitioner's Br., pp. 14-15.

and concluded it was a pledge. The case is essentially different from that at bar.

In *Sears v. Dixon,*[116] there was a provision for rent of land equivalent to interest, and the court held on account of this and other matters disclosed by the evidence the transaction was a mortgage.

Henley v. Hotaling,[117] has already been discussed.[118]

Insurance Co. v. Dutcher,[119] involves no question of sales or mortgages. It is simply an authority in favor of the principle of practical construction. In the instant case there was no evidence of a practical construction different from the provisions on the face of the instruments—a sale and repurchase.

Campbell v. Dearborn,[120] is another case where a loan actually existed and the evidence showed the intent to secure it by the conveyance. Petitioner ascribes to it as the test the question whether "the purchaser does not take the risk of the subject of the contract upon himself." We have shown that in the instant case respondent did have to stand the risks.[121] Petitioner makes this case a text for an argument[122] based upon the provision in the repurchase agreement authorizing respondent on default to sell the bonds and charge the loss to the dealer. This is not essentially different from the measure of damages for breach of a contract of sale provided by the Code itself.[123]

116. 33 Cal. 3; Petitioner's Br., p. 15.
117. 41 Cal. 22; Petitioner's Br., p. 15.
118. *Supra*, p. 17.
119. 95 U. S. 269; Petitioner's Br., p. 15.
120. 109 Mass. 130; Petitioner's Br., pp. 15, 17, 22.
121. *Supra*, p. 21.
122. Petitioner's Br., p. 22.
123. *Supra*, p. 15.

Weiss v. Stearn,[124] was not, as petitioner intimates, a case of attempted tax avoidance. It involved no question of distinguishing between sales and mortgages, no question of construction of contracts.

Neither *First Seattle D. H. Nat. Bank v. Commissioner of Int. Rev.,*[125] nor *San Joaquin Fruit & Inv. Co. v. Commissioner of Int. Rev.,*[126] presented a question regarding the distinction between sales and mortgages.

Alworth-Washburn Co. v. Helvering,[127] expressly refrained from determining whether the transaction was a sale or a loan.

There was no question of a sale in *Omaha Nat. Bank v. Mutual Ben. Life Ins. Co.*[128] The certificate there showed expressly that there was a loan and lien.

In re Grand Union Co.[129] was another case where the finance company charged interest, etc., and for that and because of other circumstances appearing on the face of the documents the court held the transaction was a loan and not a sale.

In *White v. Redenbaugh,*[130] the court held the transaction a mortgage because of the fact of a pre-existing debt, because the seller was required to continue interest payments, to pay taxes on the land and any other liens. Petitioner ascribes to this case the test of inadequacy of consideration. In the case at bar, however, the consideration

---

124. 265 U. S. 242; Petitioner's Br., p. 17.
125. 77 F. (2d) 45; Petitioner's Br., p. 17.
126. 77 F. (2d) 723; Petitioner's Br., p. 17.
127. 67 F. (2d) 694; Petitioner's Br., p. 17.
128. 81 Fed. 935; Petitioner's Br., p. 17.
129. 219 Fed. 353; Petitioner's Br., p. 17.
130. 41 Ind. App. 580, 82 N. E. 110; Petitioner's Br., p. 18.

was adequate in every instance.[131] Neither this nor any of the cases cited by petitioner and reviewed above undertakes to establish what can be the only basis of petitioner's claim here that as a matter of law a sale and repurchase must necessarily be a loan and mortgage or pledge. The fact is that the federal cases relied upon by petitioner do not question *Conway v. Alexander*[132] and that the California decisions upon which he relies do not question *Henley v. Hotaling*.[133] Both of these cases are definite authorities in favor of our position here.

In addition to these cases petitioner cites Jones on Mortgages.[134] The passage cited deals merely with inadequacy of price. It says expressly that "inadequacy of price to be of controlling effect must be gross." In the case at bar the price, we submit, was adequate. Certainly it cannot be pretended that it was grossly inadequate.

Computing Scale Co. v. Toledo Computing Scale Co.[135] is a patent infringement case. It has nothing to do with either sales or mortgages. Primarily, petitioner seems to cite it in connection with an argument[136] to the effect that respondent could not sell the bonds and therefore did not own them. The case deals neither with sales nor ownership and therefore does not support the argument. The argument itself is fallacious. The minor premise is mistaken. Respondent certainly could have sold the bonds. Doing so might have made it liable to the dealer for breach of contract if it could not deliver similar bonds when the

131. *Supra*, pp. 6, 20.
132. *Supra*, p. 13.
133. *Supra*, p. 17.
134. 8th ed., sec. 326; Petitioner's Br., p. 18.
135. 279 Fed. 648; Petitioner's Br., p. 21.
136. Petitioner's Br., pp. 20-21.

dealer called for them and tendered the price. This does not mean, however, either that respondent could not have sold the bonds or did not own them. The major premise also is mistaken. The power to alienate is not the necessary test of title. Inalienable titles are common. Suppose the owner of land gives an option to a real estate dealer who records the document. The owner can no longer alienate. The real estate dealer, like the bond dealer, could always obtain and pass good title by exercising his option and tendering the price. No one, however, would say that the real estate dealer had title. No one would question the fact that the owner had title.

First Nat. Bank in Wichita v. Commissioner of Int. Rev.,[137] we have already discussed.

The same is true of *Conway v. Alexander.*[138]

In conclusion, petitioner cites three cases[139] construing certain exemptions from taxation under state laws. These cases are not applicable here. We have not here any doubt about the tax exempt character of the bonds in question. That is conceded by petitioner.[140] Petitioner's argument is devoted to the ownership of the bonds in question. To such a question these decisions have no relevancy whatever.

137. 57 F. (2d) 7; Petitioner's Br., p. 27. *supra*, pp. 3-4.
138. 7 Cranch 217; Petitioner's Br., p. 28, *supra*, p. 13.
139. *Pacific Co. v. Johnson*, 285 U. S. 480; *J. W. Perry Co. v. Norfolk*, 220 U. S. 472; *Bank of Commerce v. Tennessee*, 161 U. S. 134; Petitioner's Br., p. 28.
140. R. 46.

CONCLUSION.

The situation presented by this record is simple in the extreme. The bonds in question bore interest coupons entitling the holder to interest. That interest was exempt from the income tax. There was no doubt of the exemption. That very exemption made the bonds sell at a higher price so that the income yielded by them was less than a lender would require on ordinary loans, whose interest was subject to income tax. Relying on that exemption, respondent bought the bonds at prices which made them yield less income than it would have received on an ordinary loan. Petitioner seeks now to tax the interest and deprive respondent of the benefit of the exemption for which it paid. Petitioner's argument is that while respondent did buy the bonds and pay for them, nevertheless it is to be taxed as if it had not bought the bonds, as if the price it had paid for the bonds was merely a loan made to the dealer. The theory is directly contrary to the language of the instruments, to the intention of the parties, to the findings of the Board and to the general rule as laid down by decisions both of the Supreme Court of the United States and of the State of California. Even assuming, however, everything for which petitioner contends, granting for the sake of argument that respondent did not own the bonds but that the dealer held title to them all the time, this cannot change the fact admitted by petitioner himself that it was respondent who collected the coupons, who received the interest on the tax exempt bonds. Irrespective of the ownership of the bonds themselves, it is well settled under such circum-

stances that the receiver of the interest is entitled to the exemption that goes with the receipt of the interest.

The decision of the Board should be affirmed.

Dated, San Francisco,
October 23, 1935.

Respectfully submitted,
F. D. Madison,
Alfred Sutro,
Felix T. Smith,
Marshall P. Madison,
Attorneys for Respondent.